In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 299

UNITED STATES OF AMERICA, *Petitioner*

v.

N. WALSER EDENS and W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, *Debtor*

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum opinion of the referee in bankruptcy (R. 1-4) is unreported. The opinion of the District Court (R. 4-8) is reported in 97 F. Supp. 793. The opinion of the Court of Appeals (R. 9-12) is reported in 189 F. 2d 876.

JURISDICTION

The judgment of the Court of Appeals was entered on June 6, 1951. (R. 12.) The petition for a writ of certiorari was filed September 4, 1951, and was granted on November 5, 1951. (R. 14.) The jurisdiction of this Court rests on the provisions of 28 U. S. C. 1254.

QUESTION PRESENTED

Whether, in a corporate reorganization proceeding under Chapter X of the Bankruptcy Act, the United States is entitled to interest on unpaid taxes for the period following the date of the filing of the petition for reorganization.

STATUTES INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 25-29.

STATEMENT

On November 11, 1948, the debtor, Carolina Mills, Inc., a South Carolina corporation, filed a petition for reorganization under Chapter X of the Bankruptcy Act. (R. 4.) In that proceeding, the United States filed claims for unemployment taxes, federal insurance contributions taxes, and income taxes collected by withholding. No question is raised as to the principal amount of these taxes nor as to interest up to the date of the filing of the reorganization petition. (R. 4.) The referee al-

lowed the full amount of the taxes with interest at the rate of 6% to November 11, 1948. (R. 4.)

The sole question presented is whether the tax claims bear interest subsequent to November 11, 1948, the date of the filing of the reorganization petition. (R. 1.) After a hearing, the bankruptcy referee denied post-petition interest (R. 4), and the District Court adopted and confirmed the referee's decision (R. 8). Upon appeal by the United States, the court below affirmed the order of the District Court, holding that the United States is entitled to interest on its tax claims only to date of the filing of the petition in reorganization. (R. 12.)

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In holding that interest on unpaid tax claims of the United States should be allowed only to the date of filing of the petition for reorganization under Chapter X of the Bankruptcy Act.

2. In failing to hold that interest on tax claims of the United States should be allowed after the date of the filing of the petition in reorganization and until the taxes are paid or otherwise satisfied.

3. In affirming the order of the District Court.

SUMMARY OF ARGUMENT

Although the Internal Revenue Code provides that, if a tax is not paid when due, interest at the rate of six percent shall be added as part of the tax until it is paid, this Court held, in *New York* v.

Saper, 336 U. S. 328, that, in straight bankruptcy, interest on taxes ceased as of the date of the petition. The basis of this decision was that interest on debts generally is cut off as of the date of the petition in straight bankruptcy proceedings, and that Congress has indicated an intent that taxes shall be treated in a manner similar to other debts. The court below held the same rule applicable to a reorganization proceeding under Chapter X.

The rule with respect to interest generally in straight bankruptcy is founded on the nature of the proceedings which are designed for liquidation, not reorganization. In Chapter X, the assets of the estate are used to maintain a going business in order to preserve their maximum value with the ultimate aim of reorganizing the business rather than dissolving it. The statutory limitation on interest, applicable in straight bankruptcy, is not carried over to Chapter X. It is therefore appropriate that the claims of creditors and stockholders be taken as of the date the reorganized corporation succeeds to the debtor's estate, rather than as of the date of the petition.

Although it may be argued from the nature of Chapter X proceedings that post-petition interest should be computed on all claims, it is not necessary to go that far in the present case since here the claim is entitled to priority and there is additional basis for paying interest on claims entitled to priority. The absolute priority rule, embodied

in the statutory requirement that a plan must be fair and equitable, requires that all of the rights of creditors holding priorities must be fully compensated before junior claimants receive anything. Under this rule, it has been consistently held that the right to interest to the effective date of the plan of reorganization is one of the bundle of rights for which compensation must be provided.

In contrast with the situation in straight bankruptcy, the terms of the Bankruptcy Act with respect to Chapter X proceedings reaffirm, rather than depreciate, the priority given federal tax claims. The basic priority provided by Section 3466 of the Revised Statutes is supported by Section 199 of the Bankruptcy Act, and, in fact, federal taxes are given a sort of super priority. Nor do the particular sections of the Bankruptcy Act on which this Court relied as showing a Congressional purpose to abolish the priority of tax claims in straight bankruptcy apply to Chapter X.

The effect of the holding of the court below is to relegate the tax claims of the Federal Government to a position inferior to that of other creditors. There is no sanction for such a holding in the *Saper* case, which at most requires only that tax claims should receive comparable treatment to that given claims of creditors of equal rank. The *Saper* case thus supports the Government's right to interest in those proceedings particularly since federal tax claims retain their priority status in reorganization proceedings.

ARGUMENT

In a Corporate Reorganization Proceeding Under Chapter X of the Bankruptcy Act, the United States Is Entitled to Interest on Unpaid Taxes for the Period Following the Date of the Filing of the Petition for Reorganization.

The Internal Revenue Code provides that if social security and withholding taxes are not paid when due there shall be added "as part of the tax" interest "at the rate of 6 per centum per annum from the date the tax became due until paid." (26 U.S.C. 1420 (b), 1605 (b), and 1627. Appendix, *infra*, pp. 25-26.)[1] However, this Court held in *New York* v. *Saper*, 336 U.S. 328, that, in the case of straight bankruptcy, the Government's right to interest stops at the date of the filing of the petition. The question here is whether the same limitation applies in proceedings for corporate reorganization under Chapter X of the Bankruptcy Act.[2] (30 Stat. 544, Section 101, *et seq.*, as amended

[1] A comparable provision imposes interest on unpaid income taxes. 26 U. S. C. 294. A review of the statutory antecedents of this section shows that Congress intended by it to require the payment of interest on delinquent taxes by the trustee or assignee of an insolvent estate. (See pp. 13 to 17 of petitioner's brief in *United States* v. *Bloom*, No. 100, this Term, filed at the same time as this brief.) This background was called to this Court's attention in the *Saper* case, but the Court indicated that it believed the Bankruptcy Act was controlling where bankruptcy was involved. *New York* v. *Saper*, 336 U. S. 328, fn. 18 at 340-341.

[2] *United States* v. *General Engineering and Manufacturing Company*, No. 300, to be heard immediately after this case, involves a like question with respect to a proceeding for

by the Act of June 22, 1938 (Chandler Act), 52 Stat. 883 (11 U.S.C. 501, *et seq.*).)

The court below denied the Government's claim to post-petition interest on the assumption that Chapter X proceedings are a kind of bankruptcy in which creditors have the same rights as in straight bankruptcy (R. 10-11). The Government challenges both the assumption and the conclusion. It believes that differences in the purposes and effects of the types of proceding are so fundamental that the reasoning underlying the *Saper* case itself requires that interest continue to acrue in Chapter X cases rather than that it be cut off. *In re Lexington Homes*, 94 F. Supp. 482 (D.N.J.) directly sustains the Government's position here.

A. *Differences in the nature and purpose of straight bankruptcy and Chapter X reorganization make the application of the bankruptcy rule of distribution inappropriate in reorganization proceedings.*

The fundamental basis for the holding in the *Saper* case was that, in straight bankruptcy, interest ceases to run on debts other than taxes from the date the bankruptcy petition is filed, and that Con-

---

arrangement under Chapter XI of the Bankruptcy Act, Sec. 301, *et seq.* (11 U. S. C. 701, *et seq.*) *United States* v. *Bloom*, No. 100, assigned for argument immediately prior to the instant case, involves the question of whether interest on federal taxes continues to run, in a state proceeding, after the date of an assignment for the benefit of creditors.

gress had, in amendments to the Bankruptcy Act, evinced an intention to assimilate federal tax claims to other debts. See *New York* v. *Saper*, 336 U.S. 328, 337-338. But the general rule stopping interest on other debts at the date of the petition, in the light of which this Court read the amendments to Chapters I to VII of the Bankruptcy Act enacted in 1926 and in the Chandler Act,[3] does not apply to proceedings for corporate reorganization.

1. *Bankruptcy is a device for liquidation while Chapter X is a procedure to avoid liquidation.*

Bankruptcy is directed to the winding up of a debtor's business and his discharge from creditors' claims. There is no machinery for maintaining the business as a going concern, and the sole object is the orderly liquidation of the bankrupt's assets and the distribution of the proceeds among his creditors. *Securities Comm'n* v. *U. S. Realty Co.*, 310 U.S. 434, 448. It was with respect to this type of proceeding that the courts adopted a cut-off date for interest. Mr. Justice Holmes, in *Sexton* v. *Dreyfus*, 219 U.S. 339, stated with respect to terminating interest on claims as of the date of bankruptcy, at page 344, "The rule is not unreasonable when closely considered. It simply fixes the moment when the affairs of the bankrupt are supposed to be wound up." The rule terminating in-

[3] Act of May 27, 1926, c. 406, 44 Stat. 662, 666, Sec. 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1 (11 U. S. C. 1, *et seq.*)

terest was carried over into statutory schemes for the liquidation of banks (*Merrill* v. *National Bank of Jacksonville,* 173 U.S. 131), and was incorporated into the equity receivership method of handling insolvent corporations. *Thomas* v. *Western Car Co.,* 149 U.S. 95, 116-117; *American Iron Co.* v. *Seaboard Air Line,* 233 U.S. 261, 267.[4]

As contrasted with straight bankruptcy, reorganization under Chapter X looks to the corporation's rehabilitation, and the preservation of its business as a going concern. Indeed, it may not be availed of merely for the purpose of liquidation. *Fidelity Assurance Ass'n* v. *Sims,* 318 U.S. 608, 621. "A proceeding to reorganize is not a bankruptcy, though an amendment to the bankruptcy act creates and regulates the remedy." *Lowden* v. *N. W. National Bank,* 298 U.S. 160, 163. Reason to expect that the company can be reorganized as a going concern is a condition to maintenance of the petition under Chapter X; otherwise there is lack-

---

[4] Although the equity receivership was actually used as a method of reorganizing corporations, procedurally it was a liquidation. 6 Collier on *Bankruptcy,* 14th ed. (1947), 2815, 2816; 50 Yale Law Journal 144, 147. Consummation of the plan occurred outside the judicial proceedings; the parties received new securities in the reorganized company, not from the court but pursuant to agreement with the purchaser. Observed inadequacies in reorganizations through equity receivership led to the enactment of improved facilities by the successive additions of Section 77B (Act of June 7, 1934, c. 424, 48 Stat. 911), and Chapter X to the Bankruptcy Act. *Securities Comm'n* v. *U. S. Realty Co.,* 310 U. S. 434, 448.

ing the "good faith" which the statute prescribes for the filing of a petition. (Section 146 (3), 11 U.S.C. 546.) "* * * the debtor corporation is to be regarded as a going concern and not as a moribund or defunct entity." *Petition of Portland Electric Power Co.*, 162 F. 2d 618, 621 (C.A. 9), certiorari denied, 332 U.S. 837. Again, in *Susquehanna Chemical Corp.* v. *Producers Bank & Tr. Co.*, 174 F. 2d 783, 787, the Court of Appeals for the Third Circuit said:

> But the purpose of reorganization is not liquidation at all. If reorganization is successful the debtor corporation will continue to function, to pay its creditors, and carry on its business. The purpose of reorganization is to save a sick business, not to bury it and divide up its belongings.

2. *The statutory provisions indicating a Congressional intent to cut off interest in bankruptcy are not applicable to Chapter X.*

This Court, in the *Saper* case, found in Sections 63(a)(1) and 63(a)(5) of the Bankruptcy Act (11 U.S.C. 103(a)(1), 103(a)(5)) statutory recognition of the view that interest on debts was to be cut off at the date of the petition in straight bankruptcy proceedings. These two sections allow interest on judgments and written instruments only to that date. However, this statutory enactment of the rule against accrual of interest after the

filing of the petition was expressly excluded from Section 77B (the predecessor of Chapter X) by subdivision k of that section (48 Stat. 921). While it is true that Section 63(a) is not expressly made inapplicable to Chapter X proceedings, nevertheless Section 102 of the Bankruptcy Act (11 U.S.C. 502, Appendix, *infra*, pp. 26-27) makes the provisions of Chapters I to VII applicable to Chapter X only "insofar as they are not inconsistent or in conflict with the provisions of" Chapter X. Section 106(1) (11 U.S.C. 506, Appendix, *infra*, p. 27) defines "claims" for the purposes of Chapter X to include "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent." Thus it is clear that claims other than the provable debts under Section 63 may participate in a Chapter X plan, and that the definition of provable claims under Section 63(a) with its limitation on interest is inapplicable to Chapter X.[5]

---

[5] Indeed, the entire scheme for the presentation, proof and allowance of claims in "straight" bankruptcy, of which Section 63 (a)(1) is a part, is inconsistent with the indigenous scheme for presentation, proof and allowance of claims under Chapter X. In bankruptcy the form of proof of claim is determined by Section 57(n) (11 U. S. C. 93(n)), as supplemented by the general orders and official forms. Under Chapter X the determination of the manner, in which creditors shall file proof of claim and the procedure for presenting

3. *The rule cutting off interest generally, which was the basis for the rule against interest on taxes, is therefore not necessary or appropriate to Chapter X proceedings.*

In the context of the reorganization proceedings, it would be strange if assets were permitted to be retained by the debtor or trustee, and used to continue the business during the reorganization, rather than used to pay debts, without continuing to accrue interest. This is not an instance of delay by act of law as an incident to liquidation from which it is equitable that no one should gain. See *Vanston Committee* v. *Green*, 329 U.S. 156, 163-164. The estate which enjoys the use of the asset which it owes to another should pay interest for the privilege of its use.

The concept of the imposition of interest as a penalty arising from the failure to make prompt payment has little applicability to this situation. *Thomas* v. *Western Car Co.*, 149 U.S. 95, 116-117.

---

and disputing claims, rests entirely in the discretion of the court. Section 196 (11 U. S. C. 596). Proceedings instituted under Chapter X, unlike ordinary proceedings in bankruptcy, affect and bind secured as well as unsecured creditors (Sections 216 (1), 226 (11 U. S. C. 616 (1), 626), and secured claims must therefore be filed in such proceedings. Moreover, the concept of payment and declaration of dividends prescribed by Section 65 (11 U. S. C. 105) differs entirely from the concept of participation by creditors and stockholders in the reorganized company under the plan of reorganization as provided by Section 224 (4) of Chapter X (11 U. S. C. 624 (4)).

In the first place, there is no problem of penalizing the debtor, since, if he is in fact insolvent, the sole interest in the estate belongs to the creditors and the problem is one of an equitable distribution among them. If he proves to be solvent, then interest will be imposed even in straight bankruptcy. *New York* v. *Saper,* 336 U.S. 328, fn. 7 at 330. In the second place, the interest we are concerned with is properly considered as rent for money used, rather than as a penalty for retaining property of another. Cf. *Meilink* v. *Unemployment Commission,* 314 U.S. 564; *United States* v. *Childs,* 266 U.S. 304. Property in the hands of a Chapter X trustee is used to keep the business functioning as a going concern until it can be turned over to a new company. This is not a "dead fund" such as is referred to in the English cases from which the bankruptcy rule was adopted. *Ex parte Bennet,* 2 Atk. 527 (1743).[6]

The allowance of post-assignment interest in a Chapter X proceeding does not involve "the administrative inconvenience of continuous recomputation of interest causing recomputation of claims" adverted to by this Court in *Vanston Committee* v. *Green,* 329 U.S. 156, 164. See also *New York* v.

---

[6] The Court stated at page 527, "Commissioners, after a man becomes a bankrupt, compute interest upon debts no lower than the date of the commission, because it is a dead fund, and in such a shipwreck, if there is a salvage of part to each person, in this general loss, it is as much as can be expected."

Saper, 336 U.S. 328, 334. In bankruptcy, dividends on claims are paid from time to time as the estate is turned into cash. Section 65 (b) of the Bankruptcy Act (11 U.S.C. 105 (b)). That is why continuous recomputation is necessary. On the other hand, in Chapter X proceedings, there is a fixed and specific date for computing payments, the effective date as provided in the plan of reorganization. Thus if the cut-off date for interest is to be determined on the basis of considerations of practical convenience, that date is not unreasonably fixed in a bankruptcy situation at the date the petition is filed. *Sexton* v. *Dreyfus*, 219 U.S. 339. But it is equally convenient to fix that date on the effective date of the plan in Chapter X and that date has the advantage of coinciding with the realities of the situation. Under Chapter X, the time the old enterprise ends and the new one commences is not the date of filing but the effective date of the plan when the reorganized company takes up where the old one stops. Cf. *In re Realty Associates Securities Corporation*, 163 F. 2d 387 (C.A. 2), certiorari denied, 332 U.S. 836; *United States Trust Co. of New York* v. *Zelle*, 191 F. 2d 822 (C.A. 8).[7]

[7] What has been stated above as to the nature of a Chapter X proceeding, is not contradicted by the fact that a Chapter X proceeding may end up in a liquidation. Liquidation of the debtor's property is proper at the conclusion of a Chapter X proceeding only when, at the time the petition was originally filed, it was not unreasonable to expect that a plan of

It is pointed out earlier that the court below decided the case on the ground that Chapter X is a kind of bankruptcy and that creditors have the same right as in straight bankruptcy. We believe that the preceding discussion demonstrates that the court was in error in these assumptions.

B. *As priority claims, delinquent taxes are entitled in Chapter X proceedings to interest to the date of payment under the absolute priority rule.*

The discussion under Point A would support the view that interest should be computed on all claims in Chapter X to the date of payment. It is not necessary to go so far in this case, because as will be seen, pp. 18-21, taxes are entitled to priority. Therefore, interest to the effective date of the reorganization plan is one of the fundamental rights which must be recognized in order that a plan can be found "fair and equitable" as required by Sections 174 and 221 of the Act (11 U.S.C.

---

reorganization could be effected. *Country Life Apartments* v. *Buckley*, 145 F. 2d 935, 938 (C. A. 2); *Patent Cereals* v. *Flynn*, 149 F. 2d 711 (C. A. 2). And in such cases, as in every Chapter X proceeding, the statutory requirement of a "fair and equitable" plan (Sections 174 and 221) is equally applicable. For this reason it has been asserted that the holding in *In re Capital Foundry Corp.*, 83 F. Supp. 413 (E. D. N. Y.) is "absolutely erroneous" (6 Collier, *supra* (1950 Cum. Supp.) 32). There post-petition interest on tax claims in a Chapter X proceeding was denied on the ground that the absolute priority rule did not apply since the plan provided for winding up rather than rehabilitation.

574, 621). To be "fair and equitable," a plan must apply the "absolute priority" rule announced in *Northern Pacific Ry.* v. *Boyd,* 228 U.S. 482, and reapplied in *Case* v. *Los Angeles Lumber Co.,* 308 U.S. 106, 115-119, and *Securities Comm'n* v. *U. S. Realty Co., supra,* p. 452. It is a part of this strict priority rule, as this Court stated in *Consolidated Rock Co.* v. *DuBois,* 312 U.S. 510, 527, in dealing with interest, which had accrued during a Section 77B proceeding (the predecessor of Chapter X), that interest until date of payment is required. Thus, this Court found the plan there involved defective, in that—

> no provision is made for the accrued interest on the bonds. This interest is entitled to the same priority as the principal.

Similarly, the Court of Appeals for the Tenth Circuit, in another Section 77B case, stated (*In re Deep Rock Oil Corporation,* 113 F. 2d 266, 269, certiorari denied, 311 U.S. 699):

> Where in the administration of the affairs of an insolvent corporation there are claims of different rank, the holders of prior claims are entitled to *interest to the time of payment,* even though the payment thereof may deprive the holders of subsequent claims of any participation in the funds of the bankrupt. [Italics supplied.]

See also *Jamieson* v. *Watters*, 91 F. 2d 61, 64 (C.A. 4).

Under the absolute priority rule, full compensatory treatment for the entire bundle of rights, which they surrender, is the due of priority claimants before claims of lower rank may be considered. Interest is one of the rights included in the bundle and is entitled to the same priority as the principal. Even senior stockholders are held entitled to dividends to the time of payment, although thereby the holders of junior stock may be deprived of any participation in the funds of a reorganized corporation. *Central States Electric Corp.* v. *Austrian*, 183 F. 2d 879 (C.A. 4), certiorari denied, 340 U.S. 917. *Petition of Portland Electric Power Co.*, 162 F. 2d 618, 622-624 (C.A. 9), certiorari denied, 332 U.S. 837, and cases cited.

Thus, in 6 Collier on *Bankruptcy, supra*, pp. 2815-2819, where the reasons for the rule are discussed at length, it is concluded (p. 2817):

> * * * that in corporate reorganizations, as a general rule, interest on all claims, whether fixed by contract or by the applicable local law, accrues until the date of the consummation of the plan and must be accorded the same priority as the principal of the claim.

In re Lexington Homes, supra, quotes with approval and follows the reasoning of this text. Indeed, the conclusion in Collier takes added signifi-

cance, when contrasted with the emphatic view taken in the same work against allowance of interest on taxes pending ordinary bankruptcy (3 Collier, *supra*, Sec. 63.16, pp. 1841-1844), anticipating the *Saper* opinion, in which this Court cited his text (pp. 329-330, note 5). See also Note, *Allowance of Interest During Reorganization Proceedings* (1940) 50 Yale Law Journal 144.

This Court held nothing to the contrary in *Vanston Committee* v. *Green*, *supra*, cited by taxpayer's trustee in their brief in opposition to the certiorari petition (p. 3), for there a claim for payment of interest on interest alone was challenged (p. 159). We submit that the balance of equities which this Court there held (p. 165) to constitute the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization proceedings, requires the allowance of similar interest here.

C. *The priority of tax claims in Chapter X proceedings is supported by the terms of the Bankruptcy Act.*

In the *Saper* case this Court interpreted the recent amendments to the Bankruptcy Act as indicating a Congressional intent to reduce the status of tax claims in straight bankruptcies. However, the sections cited as giving evidence of this intent with respect to straight bankruptcy have no application to Chapter X reorganizations, and the pro-

visions of Chapter X on the contrary, reaffirm the priority status of tax claims owed to the United States.

The basic priority statute is not found in the Bankruptcy Act but in Section 3466 of the Revised Statutes (31 U.S.C. 191, Appendix, *infra,* p. 29). This section, in effect, provides that when a person indebted to the United States is insolvent, the debts due to the United States shall be satisfied first out of his estate. In straight bankruptcy, this general priority statute is modified by the specific provisions for priority established by Section 64(a) of the Bankruptcy Act (11 U.S.C. 104(a)). *United States* v. *Kaplan,* 74 F. 2d 664 (C.A. 2). It was this provision to which this Court made specific reference in the *Saper* case as an indication that interest should not be paid on taxes in straight bankruptcy proceedings. *New York* v. *Saper,* 336 U.S. 328, 332-335. However, Section 64(a) is specifically made not applicable to Chapter X by Section 102 (11 U.S.C. 502); and, not only this, but Section 199 (11 U.S.C. 599, Appendix, *infra,* pp. 27-28) provides that plans that do not make provision for the payment of federal taxes in full shall not be confirmed unless the Secretary of the Treasury accepts the lesser amount.[8] Thus debts to the

[8] The House Committee, which recommended Chapter X, explained the purpose of Sections 199 and 271 (Appendix, *infra,* pp. 27-29) as follows (H. Rep. No. 1409, 75th Cong., 1st sess., pp. 55-56):

> The committee believes these new tax provisions will strike a balance between the necessity of safeguarding the

United States for taxes are treated as something above and apart from other claims against the estate, in much the same manner as they were treated in straight bankruptcy prior to the amendments which this Court found ended their special status. Cf. *In re Kallak*, 147 Fed. 276 (D.N.D.).

This Court also cited Section 57(n) (11 U.S.C. 93(n)), requiring the Government to prove its claims in the same manner as other debts, and 63(a)(1) and 63(a)(5) (11 U.S.C. 103(a)(1) and 103(a)(5), fixing a cut-off date for interest with respect to certain claims, as indicating an intention by Congress to reduce the priority previously given taxes. *New York* v. *Saper*, 336 U.S. 328, 331, 332. Section 57(n) is specifically excluded from application to Chapter X by Section 102 (11 U.S.C. 502); and, as pointed out above, Section 63(a) is inconsistent with other provisions in Chapter X and is therefore excluded from application thereto. *Supra*, pp. 10-11.

Government's tax interests in a debtor corporation, or the new corporation resulting from the reorganization proceedings, and the necessity of scaling down the indebtedness of the debtor corporation in order to make the plan successful. It is felt that any leniency of this kind on the part of the Government, when its interests are properly safeguarded, will contribute to the success of the plan of reorganzation and to the general objective of preserving a business enterprise so that it may not only continue to be economically productive but also productive of future normal taxes.

The court below, in comparing Chapter X to straight bankruptcy, placed reliance on Section 200 of the Act (11 U.S.C. 600, Appendix, *infra*, p. 28). This indicates a misconception of the purpose of Section 200, which is intended to relate to such matters as the right to possession and payment before and after the approval of a petition. It has no relevance to the issue here involved. See 6 Collier on *Bankruptcy, supra*, pp. 2869, 2870.

D. *There is no warrant for treating federal claims for unpaid taxes in reorganization as inferior to other claims insofar as the allowance of interest is concerned.*

As discussed in point B of this brief, *supra*, pp. 15-18, the absolute priority rule requires that senior creditors generally receive full compensatory treatment for interest claims surrendered in reorganization before inferior claims receive anything, and even that cumulative preferred stockholders receive recognition of dividends accruing during reorganization before inferior classes of stock can participate. Yet the effect of the decision below is to deny to the United States on tax claims the same treatment given other creditors and even stockholders for interest or dividends accruing during the period subsequent to the date of the petition. As pointed out above, this subordination of tax claims is not supported by the statutes, since taxes are entitled to priority both under

Section 3466 of the Revised Statutes and Section 199 of the Bankruptcy Act. See pp. 18-20, *supra*.

The court below held that the *Saper* case required the denial of interest here (R. 10, 11). Yet the principle enunciated in the *Saper* case is that Congress intended to assimilate federal tax claims to other debts, not to afford them less favorable treatment. Hence, under the reasoning of the *Saper* case itself, interest on federal tax claims should be permitted to run in Chapter X proceedings.

The court below stated that "It could hardly have been contemplated that a tax claim filed in a Chapter X proceeding should be entitled to post bankruptcy interest upon a reorganization of the debtor but not if reorganization should fail and an adjudication of straight bankruptcy should follow." (R. 10) But this consequence seems no more difficult than the admitted exception to the rule in the case of straight bankruptcy, where interest is permitted if the debtor proves solvent. See *New York* v. *Saper, supra*, fn. 7, p. 330.[9] All that is required is that if the case is transformed into a straight bankruptcy case, taxes, like other debts, be refused post-petition interest; if a plan

[9] If a reorganization petition is filed in the course of a straight bankruptcy proceeding, the interest which a claim bore during bankruptcy, but which would not have been allowed, will be regarded as part of the claim for the purpose of the reorganization. 6 Collier, *supra*, p. 2819.

can be worked out, then taxes, like other claims, should be allowed interest.

The allowance of interest is very strongly indicated when a plan can be worked out under which stockholders of the debtor are permitted to participate in the reorganization, an eventuality clearly contemplated by Chapter X.[10] Under such a plan the situation is comparable to that in which the debtor in a straight bankruptcy proceeding is found not to be in fact insolvent. *American Iron Co.* v. *Seaboard Air Line, supra,* pp. 266-267. However, the payment of interest should not be made dependent on whether stockholders are permitted to participate, since rehabilitation of a debtor corporation may be worked out by turning the control over to bondholders with the same result of

---

[10] In the case at bar, the original finding of the referee, which was confirmed by the district Court and the court below, contained some recognition of this situation when it stated, "This finding relates to the payment of debts and liabilities by the Trustees under the Reorganization proceeding. I am not passing upon what claim the United States might have against Carolina Mills, Inc., should eventually all debts be liquidated and the assets returned to Carolina Mills, Inc., as a solvent corporation" (R. 4). However, the wording of this paragraph would seem to refer to a situation where the petition under Chapter X is dismissed rather than to a situation where a reorganization plan is approved which recognizes a continuing interest in the stockholders. As we understand the exception recognized by this Court, interest should be allowed in either case. Even on this restricted phase of the case, it would therefore seem that the action in disallowing the claim before the solvency of the debtor was determined was premature.

maintaining the enterprise rather than dismembering it. So far as priority claimants are concerned, the result would be the same.

CONCLUSION

The decision of the Court of Appeals for the Fourth Circuit should be reversed.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

ELLIS N. SLACK,
Acting Assistant Attorney General.

JOHN F. DAVIS,
I. HENRY KUTZ,
Special Assistants to the Attorney General.

DECEMBER, 1951.

APPENDIX

Internal Revenue Code:

SEC. 1420 (26 U.S.C. 1420.) COLLECTION AND PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.

* * *

SEC. 1605 (26 U.S.C. 1605.) PAYMENT OF TAXES.

* * *

(b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 6 per centum per annum from the date the tax became due until paid.

* * *

SEC. 1627 (26 U.S.C. 1627). [as added by the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 2]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this

subchapter, be applicable with respect to the tax under this subchapter.

Bankruptcy Act, c. 541, 30 Stat. 544 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]:

CHAPTER X—CORPORATE REORGANIZATIONS

* * *

SEC. 101 (11 U.S.C. 501.) The provisions of this chapter shall apply exclusively to proceedings under this chapter.

SEC. 102 (11 U.S.C. 502.) The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under

section 127 or 128 of this Act except where an adjudication had previously been entered.

SEC. 106 (11 U.S.C. 506). For the purposes of this chapter, unless inconsistent with the context—

(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;

* * *

SEC. 199 (11 U.S.C. 599). If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claim against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confirmed by the judge except upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court: *Provided,* That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan

has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed.

SEC. 200 (11 U.S.C. 600). Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and, upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.

* * *

SEC. 266 (11 U.S.C. 666). In addition to the notices elsewhere expressly provided, the clerk and, in the case of a reference, the referee, after such reference, shall forthwith transmit to the Secretary of the Treasury copies of all petitions, answers, orders, and applications, as more specifically enumerated in section 265 of this Act, and copies of such other papers filed in the proceedings as the Secretary of the Treasury may request or which the court may direct be transmitted to him. Copies of the opinions or reports, if any, of the judge, referee, or special master, with respect to the matters so enumerated, shall also be transmitted to the Secretary of the Treasury. An order fixing the time for confirming a plan which affects claims or stock of the United States shall include a notice to the Secretary of the Treasury of not less than thirty days.

SEC. 271 (11 U.S.C. 671). Any provision in this chapter to the contrary notwithstanding,

all taxes which may be found to be owing to the United States or any State from a debtor within one year from the date of the filing of a petition under this chapter and have not been assessed prior to the date of the confirmation of a plan under this chapter, and all taxes which may become owing to the United States or any State from a receiver or trustee of a debtor or from a debtor in possession, shall be assessed against, may be collected from and shall be paid by the debtor or the corporation organized or made use of for effectuating a plan under this chapter: *Provided, however,* That the United States or any State may in writing accept the provisions of any plan dealing with the assumption, settlement, or payment of any such tax.

Revised Statutes:

SEC. 3466 (31 U.S.C. 191). Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed.

☆ U.S. GOVERNMENT PRINTING OFFICE 1951—981082/PO 987

13

Office - Supreme Court
FILED
JAN 7 1952
CHARLES ELMORE CROPLEY
CLERK

No. 299

In the Supreme Court of the United States

OCTOBER TERM, 1951

UNITED STATES OF AMERICA, *Petitioner,*

versus

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, *Debtor.*

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

BRIEF ON MERITS FOR RESPONDENTS

HENRY HAMMER
Counsel for Respondents.

The R. L. Bryan Company, Legal Printers, Columbia, S. C.

INDEX

PAGE

Opinions below 1

Jurisdiction 1

Question presented 2

Statutes involved 2

Statement 2

Summary of Argument 2

Argument:

Tax claim of the United States in a corporate reorganization proceeding bears interest until the date of the filing of the petition for reorganization, and not until payment 5

A. The rationale of the decision of this Court in *New York v. Saper*, 336 U. S. 328, is applicable to a corporate reorganization proceeding under Chapter X of the Bankruptcy Act 5

B. Section 199, 11 U. S. C. A. does not either expressly or by implication contain any exception in favor of tax claims to the rule that interest ceases to accrue upon the filing of a petition for reorganization 8

C. The reasons and equitable considerations for cutting off interest upon the filing of a petition are stronger and more compelling in a Chapter X proceeding than in a straight bankruptcy or equity receivership 12

Conclusion 14

Appendix 15

CITATIONS

PAGE

Cases:

Brent v. Bank of Washington, D. C. 10 Pet. 596, 9 L. Ed. 547 10

Case v. Los Angeles Lumber Co., 308 U. S. 106 9

Central States Electric Corp. v. Austrian, 183 F. (2d) 879, certiorari denied, 340 U. S. 917 9

Gardner v. New Jersey, 329 U. S. 565, ...3, 6, 8

Kallak, In re., 147 Fed. 276 8

New York v. Saper, 336 U. S. 328 .....2, 5, 6, 7, 8, 10, 12

Northern Pacific Ry. v. Boyd, 228 U. S. 482 9

Portland Electric Power Co., Pt. of, 162 F. (2d) 618, certiorari denied, 332 U. S. 837 9

Securities Comm'n v. U. S. Realty Co., 310 U. S. 434 4, 9, 13

Sexton v. Dreyfus, 219 U. S. 339 .....2, 4, 9

Thomas v. Western Car Co., 149 U. S. 95 2

Ticonic National Bank v. Sprague, 303 U. S. 406 13

U. S. v. State of Oklahoma, 261 U. S. 253 9

Vanston Bondholders Prot. Com. v. Green, 329 U. S. 156 .....2, 4, 9, 12

Wilson v. City Bank, (U. S.) 17 Wall. 473, 21 L. Ed. 723. 12

Statutes:

Bankruptcy Act, Sec. 77B, as amended by Act of June 7, 1934, 48 Stat. 911, 921 10

Bankruptcy Act, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840:

C. I-VII 3, 4, 6, 10, 14, 15

C. X 2, 3, 4, 6, 10, 12, 13, 14, 16

Sec. 57 (11 U. S. C. 97) 6

Sec. 63 (11 U. S. C. 103) 5, 6, 7, 15

CITATIONS—Continued

PAGE

Sec. 67 (c) (11 U. S. C. 107c) 3, 7, 8, 10, 15
Sec. 102 (11 U. S. C. 502) 6, 16
Sec. 106 (11 U. S. C. 506) 6, 7, 8, 16
Sec. 111 (11 U. S. C. 511) 13
Sec. 196 (11 U. S. C. 596) 6, 8
Sec. 199 (11 U. S. C. 599) 3, 8, 10, 17
Sec. 200 (11 U. S. C. 600) 7, 17

Miscellaneous:

79 Cong. Record, Part 13, p. 14658 11
House Report No. 1366, 74th Cong., 1st Sess., p. 2 ...3, 10
Remington on *Bankruptcy* (1947) Vol. XI, Section 4345, p. 8 13
Remington on *Bankruptcy* (5th Ed.), Volume I, Section 1, p. 5 12
Senate Report No. 1386, 74th Cong. 1st Sess., p. 2 ...3, 10

In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 299

UNITED STATES OF AMERICA, *Petitioner,*

versus

N. WALSER EDENS AND W. H. CORRY, AS TRUSTEES OF CAROLINA MILLS, INC., A CORPORATION OF SOUTH CAROLINA, *Debtor.*

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

---

BRIEF ON MERITS FOR RESPONDENTS

OPINIONS BELOW

The report of the Referee, the opinion of the District Court and the Court of Appeals are adequately referred to in the Brief for the United States.

JURISDICTION

The jurisdictional requirements are adequately set forth in the Brief for the United States.

QUESTION PRESENTED

Whether a claim of United States for unpaid taxes in a corporate reorganization proceeding under Chapter X of the National Bankruptcy Act bears interest subsequent to the date of the filing of a petition for reorganization.

STATUTES INVOLVED

The relevant statutory provisions are printed in the Appendix, *infra*, pp. 15-17.

STATEMENT

The statement of the case is adequately set forth in the Brief for the United States.

SUMMARY OF ARGUMENT

The rationale of the decision of this Court in *New York v. Saper*, 336 U. S. 328, is applicable to a reorganization proceeding under Chapter X of the Bankruptcy Act. In the *Saper case* this Court held that taxes are assimilated to debts for all purposes, including the denial of post-bankruptcy interest. The rule denying post-petition interest, which stems from the English Bankruptcy system, has been followed in equity receivership proceedings, *Thomas v. Western Car. Co.*, 149 U. S. 95, 116, 117, and applies with equal force to a proceeding under Chapter X of the Bankruptcy Act, *Vanston Bondholders Prot. Com. v. Green*, 329 U. S. 156, 163, 164. This rule is founded upon equitable considerations, one of which is that the delay in payment of debts is an act of the law, and, consequently, it would be inequitable for any one to gain an advantage or suffer a loss because of such delay. *Sexton v. Dreyfus*, 219 U. S. 339, 346. That a claim of the United States for taxes in a Chapter X proceeding, like such a claim in what is termed an ordinary or straight bankruptcy proceeding, is assimi-

lated to other debts, is clearly evident by a reading of the express provisions of the Bankruptcy Act, *Gardner v. New Jersey*, 329 U. S. 565, 572-574. Thus, since the delay in the payment of debts to creditors in a proceeding under Chapter X is an act of the law, and since a claim for taxes in such a proceeding, as in straight bankruptcy, is assimilated to debts, it logically follows that interest on a claim for unpaid taxes of the United States must be cut off, as a general rule, upon the filing of a petition for reorganization under Chapter X.

The Bankruptcy Act contains no express exception to the rule denying interest accruing subsequent to the beginning of a proceeding. The Government contends that Section 199, 11 U. S. C. A. 599, gives taxes a *super*-priority status, from which it concludes that interest on taxes should accrue subsequent to the filing of a petition for reorganization under Chapter X. With such conclusion we sharply disagree. In the first place, claims of the Government for taxes on personal property are subordinate to claims for wages and administration expenses, Section 67 (c), 11 U. S. C. A. 107c. Secondly, the *indicia* of legislative intent in enacting Section 199 of the Bankruptcy Act fails to disclose that this section was enacted for the purpose of giving any different treatment to claims of the United States for taxes in a Chapter X proceeding than in a straight bankruptcy proceeding. To the contrary, the reports of the House and Senate Committees on the Judiciary, *infra*, pp. 10-11, unequivocally indicate that this section was enacted for the purpose of giving the Government in regard to its claims for taxes a priority status equal to that which it enjoys in a straight bankruptcy proceeding, and to fix the agency to represent all departments of the Government in the matter of filing claims and accepting compromises thereon.

The Government further contends that the "absolute priority rule" excepts a claim for taxes in a Chapter X proceeding from the general rule denying post-petition interest. We respectfully submit that the "absolute priority rule" does not in itself except a claim for taxes from the general rule denying post-petition interest, unless, of course, the estate is more than sufficient to pay the claims of creditors, or, in the case of secured creditors the amounts of principal and interest aggregate less than the value of the security. *Sexton v. Dreyfus, supra; Vanston Bondholders Prot. Com. v. Green, supra.* The equitable consideration that no one should gain an advantage or suffer a loss because of delay in the payment of debts as a necessary incident to the settlement of an estate decisively strikes down the Government's interpolation that as a general rule the allowance of post-petition interest on taxes is embodied within the meaning of the absolute priority rule.

The primary purpose of the bankruptcy laws, which include both straight bankruptcy and corporate reorganization proceedings, is to secure a just distribution of funds among creditors. The fund for the distribution to creditors is usually greater if the proceedings are carried out under Chapter X than in a straight bankruptcy. One of the purposes of embodying Chapter X in the Bankruptcy Act is the preservation of the assets as a going concern, thus resulting in an increased value of each creditor's share of the fund. Practically every phase of a Chapter X proceeding is under the control of the Court, *Securities Comm'n v. U. S. Realty Co.*, 310 U. S. 434, 449-450, thus making the delay in distribution to creditors even more an incident of law than in an equity receivership or straight bankruptcy proceeding. Consequently, when the nature of a Chapter X proceeding and the purposes for which this Chapter was embodied in the Bankruptcy Act are consid-

ered, the underlying principles for denial of interest on claims in general and taxes in particular after the filing of a petition in such a proceeding become even more compelling and stronger than in an equity receivership or straight bankruptcy proceeding.

ARGUMENT

Tax Claim of the United States in a Corporate Reorganization Proceeding Bears Interest Until the Date of the Filing of the Petition for Reorganization, and not Until Payment.

The decision of the Court of Appeals for the Fourth Circuit in the instant case is clearly correct. It is in accord with the prior settled decisions of this Court, is based upon the pertinent provisions of the Bankruptcy Act, and rests upon sound equitable principles.

A. The rationale of the decision of this Court in New York v. Saper, 336 U. S. 328 is applicable to a corporate reorganization proceeding under Chapter X of the Bankruptcy Act.

This Court, in *New York v. Saper,* 336 U. S. 328, held that interest on a tax claim of the Government ceases to accrue at the beginning of a bankruptcy proceeding. The Court observed that under Sections 63 (a) (1), 11 U. S. C. A. 103 (a) (1) and 63 (a) (5), 11 U. S. C. A. 103 (a) (5) (Appendix, *Infra,* p. 15) interest on debts generally is allowed only until the date of the filing of the petition; that no provision permits post-bankruptcy interest on claims in general or tax claims in particular; that tax claims are required to be proved in the same manner and within the same time as other debts; and they are treated the same as other debts except for the fourth priority of payment. The Court thus reasoned that taxes are assimilated to

debts for all purposes, including denial of post-bankruptcy interest.

It is respectfully submitted that reference to the relevant provisions of the Bankruptcy Act makes it apparent that the reasoning of the Court in the *Saper case* should equally apply to a corporate reorganization proceeding. Before adverting to the statutes, it should be distinctly borne in mind that the *Saper case* was decided under the present Bankruptcy Act which embodies reorganization proceedings under Chapter X. Sections 63 (a) (1) and 63 (a) (5), applicable to Chapter X proceedings, as interpreted in the *Saper case*, limit interest on claims generally in a corporate reorganization proceeding to the date of the filing of a petition. There is no provision in Chapter X which permits the allowance of interest accruing subsequent to the filing of the petition for reorganization on claims in general or tax claims in particular. Although the Court in the *Saper case*, in observing that tax claims were required to be proved in the same manner and within the same time as other claims, adverted to Section 57n, 11 U. S. C. A. 97, the provisions of which are expressly made inapplicable to Chapter X proceedings by Section 102, 11 U. S. C. A. 502 (Appendix, *Infra*, p. 16), nevertheless, reference to Section 196, 11 U. S. C. A. 596 (Appendix *Infra*, p. 16) makes it apparent that in a corporate reorganization proceeding tax claims are required to be proved in the same manner and within the same time as other debts. "And the sweeping, all inclusive definitions of 'claims' and 'creditor' in" Section 106, 11 U. S. C. A. 506 (Appendix, *Infra*, p. 16), leave no doubt that tax claims fall within the provisions of Section 196, 11 U. S. C. A. 596 (Appendix, *Infra*, p. 16), *Gardner v. New Jersey*, 329 U. S. 565, 572, 573. Claims of the United States for taxes on personal property are expressly subordinated to claims

for wages and administration expenses in reorganization proceedings. Section 67 (c), 11 U. S. C. A. 107c (Appendix, *Infra*, p. 15.) Thus, following the reasoning of this Court in the *Saper case*, it becomes crystal clear that in a reorganization proceeding taxes are assimilated to debts for all purposes, including the denial of interest accruing subsequent to the filing of the petition This conclusion becomes even more compelling when we consider the express provision of Section 200, 11 U. S. C. A. 600 (Appendix, *Infra*, p. 17), which reads that "the rights, duties, and liabilities of **creditors** and of all other persons with respect to the property of the debtor shall be the same, before approval of the petition, as in a bankruptcy proceeding before adjudication, **and upon approval of the petition, as in a bankruptcy proceeding upon adjudication.**" (Emphasis added.)

The Government, recognizing the impact of Mr. Justice Jackson's statement at page 338 of the *Saper case*, wherein he said:

> "Considered in conjunction with the general rule against post-bankruptcy interest as well as § 63's limitation of interest on other claims to date of bankruptcy, they compel our conclusion, already stated, that the statute as amended did not contemplate any exception in favor of tax claims.",

now seeks to argue that Section 63 of the Act is not controlling herein in view of the provisions of Section 106 (1), 11 U. S. C. A. 506 (Appendix, *Infra*, p. 16). A reading of Section 106 (1) shows nothing more than that the definition of "claims" is made broader than those under Section 63, and includes, rather than excludes, all claims enumerated under Section 63. We thus fail to see by what logic the Government can reasonably and soundly argue that because Section 106 (1) is an enlargement of Section 63, it becomes inapplicable to a Chapter X proceeding.

B. Section 199, 11 U. S. C. A. 599 does not either expressly or by implication contain any exception in favor of tax claims to the rule that interest ceases to accrue upon the filing of a petition for reorganization.

The Government relies strongly upon the provisions of Section 199, 11 U. S. C. A. 599 (Appendix, *Infra*, p. 17), in contending that there is no limitation of interest on tax claims to date of the filing of the petition. It argues that this section places the Government in the same status it enjoyed in the case of *In Re Kallak*, 147 Fed. 276 (D. C. N. Da.). It also agrues that this section gives the Government a *super*-priority status which entitles it to post-petition interest under the "absolute priority rule".

Reference to the *Kallak case* discloses that the decision therein was based upon the theory that taxes under the Bankruptcy Act of 1898 did not constitute "claims", and were not required to be proved. *N. Y. v. Saper*, 336 U. S. 328, 333, 334. As already pointed out, under our present Act, taxes constitute claims, Section 106, 11 U. S. C. A. 506 (Appendix, *Infra*, p. 16), and are required to be proved like other ordinary debts, Section 196, 11 U. S. C. A. 596 (Appendix, *Infra*, p. 16). *Gardner v. New Jersey*, 329 U. S. 565, 572, 573. Thus, the decision in the *Kallak case* is inapplicable and not controlling herein.

The Government's contention that Section 199 gives taxes a *super*-priority status is decisively refuted by the provisions of Section 67 (c), 11 U. S. C. A. 107c (Appendix, *Infra*, p. 15), which expressly subordinates tax claims of the Government, even when clearly ascertained and valid, on personal property, to wage claims and administration expenses. And even assuming, but not admitting, that Section 199 gives taxes the priority status which the Government claims, we respectfully submit that the "absolute priority rule" does not support the Government's con-

tention that taxes in a reorganization proceeding bear interest subsequent to the filing of a petition.

Under the "absolute priority rule", beginning with the topmost class of claims against debtor, each class of claimants in descending right must be fully and completely compensated before the next class below may participate. We have no quarrel with this principle of law, but sharply disagree with the Government's interpolation that post-petition interest on tax claims of the United States, in reorganization proceedings generally, falls within the meaning of that rule. *Sexton v. Dreyfus*, 219 U. S. 339; *Vanston Bondholders Protect. Com. v. Green*, 329 U. S. 156, 164. Of course, under the "absolute priority rule", if the assets prove to be more than sufficient to pay all claims, both principal and interest would be required to be paid to unsecured or general creditors before stockholders could participate in a plan; and in cases of insolvency, secured creditors would be entitled to post-petition interest if the security proved to be of sufficient worth to pay both principal and interest, even though by reason thereof other creditors might not participate in a plan. The cases cited by the Government relating to the absolute priority rule, *Northern Pacific Ry. v. Boyd*, 228 U. S. 482; *Case v. Los Angeles Lumber Co.*, 308 U. S. 106; *Securities Comm'n v. U. S. Realty Co.*, 310 U. S. 434; *Central States Electric Corp. v. Austrian*, 183 F. (2d) 879 (C. A. 4) certiorari denied, 340 U. S. 917; *Petition of Portland Electric Power Co.*, 162 F. (2d) 618, certiorari denied, 332 U. S. 837, deal only with the priority rights between preferred stockholders and common stockholders; and between stockholders and creditors. They have no application to the facts herein. Moreover, it must be remembered that the Government is not a secured creditor as against a particular security or fund, *U. S. v. State of Oklahoma*, 261 U. S.

253, 259; nor does the priority which attaches by the Statute destroy any prior legal liens, *Brent v. Bank of Washington, D. C.*, 10 Pet. 596, 9 L. Ed. 547. Therefore, like other general creditors, regardless of any priority status given to the Government under the Bankruptcy Act, it is not entitled to interest subsequent to the filing of the petition. To hold otherwise would place the Government's claim in a status superior to wages and administration expenses, contrary to the provisions of Section 67 (c) 11 U. S. C. A. 107 (c) (Appendix, *Infra*, p. 15).

That Section 199 of the Act does not except tax claims from the rule announced in the *Saper case* denying post-bankruptcy interest is clearly evident from the reports of both House and Senate Committees on the Judiciary in reporting on the purpose of the legislation (Section 199) dealing with claims of the Government in Chapter X proceedings. Under the general Bankruptcy Act claims for taxes are given a priority status, whereas under Section 77B, the predecessor to Chapter X, the Government was placed in the status merely of a general creditor in regard to claims for taxes. Therefore, to accord taxes equal priority in both straight bankruptcy and corporate reorganization proceedings, the provisions of Section 199 were enacted. See House Report No. 1366, 74th Cong., 1st Sess., p. 2,[1] and Senate Report No. 1386, 74th Cong., 1st Sess.,

[1] The reason why Section 199, an amendment to the original provisions of Section 77B (c) (1) was thought desirable is set forth in the report of the House Committee on the Judiciary which considered H. R. 7858. (H. Rep. No. 1366, 74th Cong., 1st Sess., p. 2.) In this report the following is stated: "This amendment clarifies the rights of the Government with reference to tax claims against corporations reorganizing under section 77B of the Bankruptcy Act. It was introduced at the request of the Treasury Department. The Treasury Department has called the attention of your committee to the fact that whereas claims for taxes have priority under the general Bankruptcy Act, the language of the reorganization section is being interpreted in the lower courts (the Supreme Court not having passed on the point to date) as placing the Government in the status merely of a general creditor with regard to claims for taxes. It is apparent that under these circumstances unless remedial amendment is speedily made to the statute the Government stands to lose large sums of tax moneys which the Treasury Depart-

p. 2.[2] Another purpose was to fix a central agency to represent all departments of the Government having claims in corporate reorganization proceedings. See statement of Representative Chandler in 79 Cong. Record, part 13, p. 14658.[3] It is significant that Section 199 is silent as to interest, and we submit that, quoting from the opinion of the District Judge in the instant case, "it would have been so easy, as is well pointed out by Mr. Justice Jackson, for the Congress to have clearly set forth its desire that tax liens should draw interest until payment. Congress has not done so."

---

ment representatives estimated to your committee would aggregate several millions of dollars."

[2] Similar language was used by the Senate Committee on the Judiciary in reporting on the same bill. In S. Rep. No. 1386, 74th Cong., 1st Sess., p. 2, the Committee said: "The Treasury Department proposed this measure in the first instance for the reason that the language of the present reorganization section is being interpreted in some of the lower courts (The Supreme Court not having passed on the point to date) as placing the Government in the status merely of a general creditor."

[3] In discussing H. R. 7858 after it included the Senate amendments, *i. e.*, when the proposed amendment was in the form in which it was finally enacted, Representative Chandler made the following statement in the House of Representatives (79 Cong. Record, Part 13. p. 14658): MR. CHANDLER: "Mr. Speaker, this bill was passed by the House for the purpose of clarifying a provision in the corporate-reorganization statute which the Seventy-third Congress passed. Some of the courts construing that statute found that Congress had failed to fix the status of Government claims during the reorganization of corporations. The House passed the bill fixing the status of Government claims, and when the bill went to the Senate the Senate amplified the statute so as to fix the agency to represent the Government in this matter in the Secretary of the Treasury for all departments of the Government, rather than to have every department of the Government that might have a claim against the corporation making separate investigations into the corporate assets. Another amendment that was added by the Senate gave the Secretary of the Treasury the right to be the agent for all of the Government organizations and make one investigation instead of several. Next, the time within which the Secretary of the Treasury, as the agent, would have to accept or reject settlements proposed in these reorganization was extended from 60 days to 90 days, giving more time for a more thorough investigation. Third, customs duties were placed in the same status as taxes in the collection of the Government claim. That is what this does."

C. The reasons and equitable considerations for cutting off interest upon the filing of a petition are stronger and more compelling in a Chapter X proceeding than in a straight bankruptcy or equity receivership.

The rule denying post-bankruptcy interest in straight bankruptcy is based upon equitable considerations: that no class of creditors should be allowed to profit at the expense of another because of a delay for which the law is responsible, *Vanston Bondholders Prot. Com. v. Green, supra*, and continuous recomputation of claims at varying rates of interest would prevent definite determination of each claimants' share and complicate the administration of the estate, *New York v. Saper, supra.*

The Government contends in its brief that these equitable considerations are inapplicable to Chapter X proceedings. We submit, however, that the very nature of a Chapter X proceeding and the purposes for which this chapter was embodied in our Bankruptcy Act make even more compelling and stronger than in a straight bankruptcy proceeding the reasons and equitable considerations underlying the rule denying post-petition interest.

The primary purpose of the bankruptcy laws is to secure a just distribution of funds among creditors. *Wilson v. City Bank* (U. S.) 17 Wall 473, 21 L. ed. 723; *Remington on Bankruptcy*, (5th Ed.), Volume I, Section 1, p. 5.[4] *Vanston Bondholders Prot. Com. v. Green, supra.* Chapter X gives creditors an additional benefit—the preservation of

---

[4] "Through subsequent developments, as more particularly hereinafter shown, the primary object of bankruptcy laws has come to be "to secure a just distribution of the bankrupt's property among his creditors; the secondary object is the release of the bankrupt from the obligation to pay his debts." As stated by District Judge Ray, who was a member of the House Judiciary Committee when the American Act of 1898 was passed, later chairman of that committee, and thoroughly familiar with the subject: "The main purpose of the bankrupt law is to prevent preferences and secure a fair and equitable division of the bankrupt estate among the creditors, not to grant discharges. This end accomplished, the bankrupt is granted a discharge from all his debts."

the assets as a going concern, *Remington on Bankruptcy*, (1947) Vol. XI, Section 4345, p. 8.[5], thus resulting in an increased value of the estate and a corresponding increase of each creditor's share in a reorganization plan. The preservation of the assets as a going concern inures to the benefit of the United States and it would be unjust and inequitable to allow the Government post-petition interest on tax claims at the expense of other creditors sharing in a plan of reorganization. It would destroy the equality among creditors as of the date of the filing of the petition. *Ticonic National Bank v. Sprague*, 303 U. S. 406, 411. Practically every phase of a Chapter X proceeding is under the control of the Court, *Securities Comm'n v. U. S. Realty, supra*, thus making the delay in distribution more an act of law than in an equity receivership or straight bankruptcy proceeding. When a petition is filed in a reorganization proceeding the assets are placed *in custodia legis*, Section 111, 11 U. S. C. A. 511. Distribution to creditors is prevented by the Court. Before a plan can be passed upon, the assets must be evaluated, the claims of creditors and stockholders must be definitely determined, and the division of creditors into classes must be fixed. It is quite evident that the allowance of post-petition interest at the varying rates applicable to the different claims sharing the estate would thus prevent a definite determination of the amount of claims. Without such determination a Court could not intelligently pass upon a plan. And a plan, although fair and feasible when proposed, might be prevented from being carried out at the time of consummation because of the changed amounts of the claims if post-petition interest were to be allowed.

---

[5] "The fundamental purpose of a proceeding under Chapter X, as contrasted to straight bankruptcy, is the preservation of the status quo—that is, the going-concern value—of the debtor until the trustees have had an opportunity to investigate its affairs and apprise the court of their true nature and to recommend a plan."

Consequently, to allow post-petition interest on tax claims of the Government in a Chapter X proceeding, in complete disregard of the reasons and equitable considerations underlying the long standing rule cutting off interest on such claims upon the filing of a petition, would permit one class of creditors to gain an advantage at the expense of another, lead to confusion and complicate the administration of the estate, and finally, would tend to the liquidation rather than the rehabilitation of ailing corporations, thus defeating the very purposes for which Chapter X was enacted as part of the Bankruptcy Act.

CONCLUSION

For the reasons stated it is respectfully submitted that the judgment of the Court below should be affirmed.

Respectfully submitted,

HENRY HAMMER,
Counsel for Respondents.

December ____, 1951.

APPENDIX

Bankruptcy Act of 1898, c. 541, 30 Stat. 544, as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1:

* * *

Sec. 63. (11 U. S. C. 103) Debts Which May Be Proved.—(a) Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * * (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments. * * *.

* * *

Sec. 67. (11 U. S. C. 107) Liens and Fraudulent Transfers.—(a) * * *

* * *

(c) Where not enforced by sale before the filing of a petition in bankruptcy or of an original petition under Chapter X, XI, XII, or XIII of this Act, though valid under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or subdivision thereof, on personal property not accompanied by possession of such property, and liens whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act, and, except as against other liens, such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act.

CHAPTER X—CORPORATE REORGANIZATIONS

* * *

Sec. 102 (11 U. S. C. 502) The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: **Provided, however,** That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act except where an adjudication had previously been entered.

* * *

Sec. 106 (11 U. S. C. 506) For the purposes of this chapter, unless inconsistent with the context—

(1) "claims" shall include all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under § 63 of this Act and whether secured or unsecured, liquidated or unliquidated, fixed or contingent;

* * *

---

(4) "creditor" shall mean the holder of any claim;

* * *

(6) "debts" shall include all claims;

* * *

Sec. 196 (11 U. S. C. 596) After the approval of the petition the judge shall prescribe the manner in which and

fix a time within which the proofs of claim of creditors and of the interests of stockholders may be filed and allowed. Objections by any party in interest to the allowance of any such claims or interests shall be heard and summarily determined by the court.

* * *

Sec. 199 (11 U. S. C. 599) If the United States is a secured or unsecured creditor or stockholder of a debtor, the claims or stock thereof shall be deemed to be affected by a plan under this chapter, and the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the claims or stock of the United States. If, in any proceeding under this chapter, the United States is a secured or unsecured creditor on claims for taxes or customs duties (whether or not the United States has any other interest in, or claims against the debtor, as secured or unsecured creditor or stockholder), no plan which does not provide for the payment thereof shall be confined by the judge upon the acceptance of a lesser amount by the Secretary of the Treasury certified to the court; *Provided*, That if the Secretary of the Treasury shall fail to accept or reject a plan for more than ninety days after receipt of written notice so to do from the court to which the plan has been proposed, accompanied by a certified copy of the plan, his consent shall be conclusively presumed.

Sec. 200 (1) U. S. C. 600.) Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, before the approval of the petition, as in a bankruptcy proceeding before adjudication and, upon the approval of the petition, as in a bankruptcy proceeding upon adjudication.